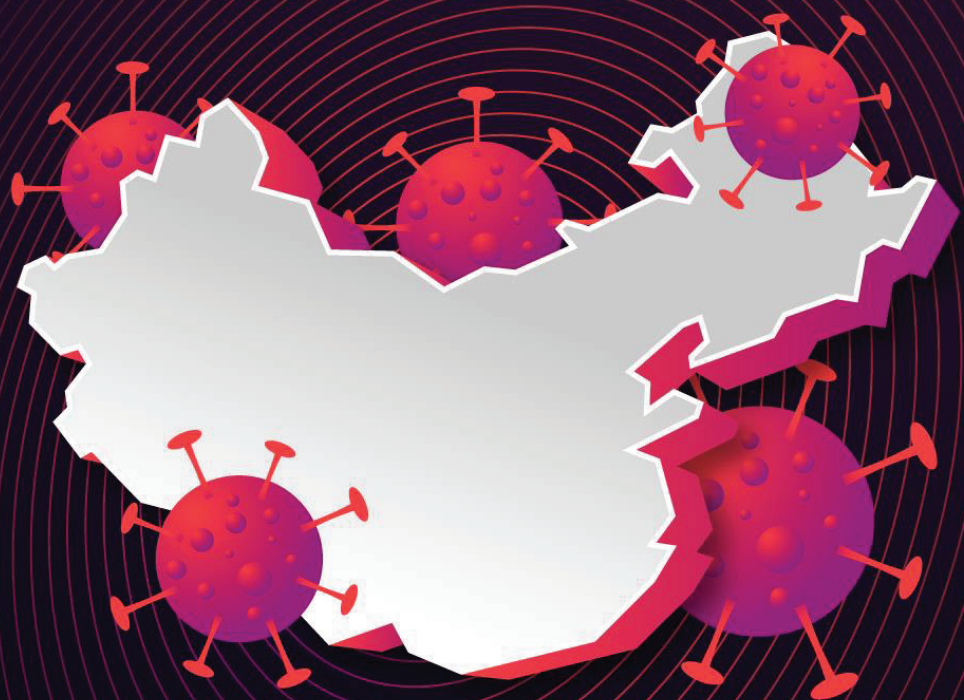


EVALUESERVE

The COVID-19 Coverage

What is happening in China?

Evaluerve Intelligence: Sector Memos
Critical Updates & Preliminary Assessment



April 2020



Background

Amid a global crisis of unprecedented scale, professional advice, expertise, and active support are more critical than ever for business leaders across the globe. The COVID-19 pandemic not only ends an uninterrupted bull-run since the global financial crisis of 2007–08, but also stress-tests business models, global supply chains, and the war chests of companies globally.

The Executive Report, COVID-19 Sector Memos (What is happening in China – April 2020), provides preliminary assessment and overall view of the ongoing cross-sector activity in China. The report aims to present the emerging risks, regulations, as well as opportunities from the COVID-19 outbreak. Since this report is time sensitive, forward-looking outlook may require ongoing monitoring.

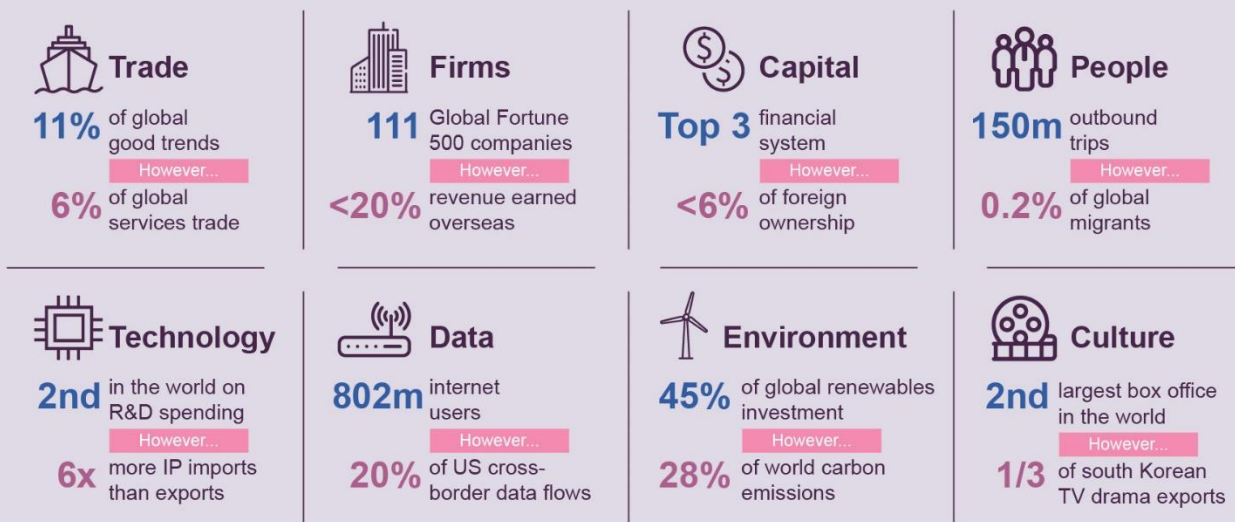
The China Entanglement: Why is it important to look at China as the COVID-19 crisis unfolds?

- According to the World Bank, a severe pandemic could wipe out 5% of global GDP (or more than \$3 trillion) and severely impact global trade. The SARS crisis of 2003-04 led to \$40 billion in global market losses. Unsurprisingly, China's share of world trade has almost doubled since the SARS outbreak. Fast forward to the present, the COVID-19 pandemic tests world's dependence on China for technology, trade and capital. In an effort to build a self-sustaining economy, China's economy has been reducing its reliance on trade as a source of growth.
- China's economic slowdown is likely to impact different regions of the world in different ways depending on their exposure and reliance on China. The slowdown in demand could have a negative impact on the GDP growth of countries that are dependent on China for commodity exports. However, the recent fall in commodity prices could be beneficial for countries that import commodities, such as the US and several European nations.
- The COVID-19 crisis will have strategic and long-term implications on global trade. Economies will highly likely moderate their over-reliance on and businesses hedge their risk exposure to China in the aftermath of the crisis, by reducing commodity exposure, diversifying and looking for alternate supply chains, hedging investment risk, preparing better risk transfer solutions and policies, and more...
- A recent study conducted by McKinsey Global institute* concluded, "China is becoming less exposed in economic terms to the rest of the world. However, reflecting China's rise to being the world's second-largest economy and its leading trading nation, the rest of the world is becoming more exposed to China..."

Some interesting facts from the report are highlighted below to set a stronger context for Sector Memos that follow:

China and the world: A changing relationship

China has achieved global scale, but more can be done to integrate



Source: McKinsey Global Institute - China and the world: Inside the dynamics of a changing relationship, July 2019*

Sources: The [World Bank](#) Report – A World at Risk - Sep 2019, [McKinsey Global Institute](#) – China and the world - Jul 2019*, Learning from SARS: Preparing for the Next Disease Outbreak: Workshop Summary by [National Academics Press \(US\)](#) – 2004, [The Balance](#), NIKKEI [Asian Review](#)



Emerging Risks, Reg and Opportunity

COVID-19 Newswire across Sectors with Focus on China








Sector	Key Players (Domestic & Foreign)	COVID-19 Newswire Emerging Risk-Reg-Opportunity
 Banking	<i>Industrial and Commercial Bank of China, China Construction Bank, Agricultural Bank of China, Bank of East Asia, HSBC, Citibank</i>	<ul style="list-style-type: none"> • Risk: China could face decade-high bad loan ratio as COVID-19 slams small businesses, SCMP - Mar 2020 • Reg: PBOC Establishes “Green Pipeline” for Issuance of Bonds by Chinese Financial Institutions During COVID-19 Outbreak, China Banking News - Feb 2020 • Opportunity: HSBC China launches SMO, as going digital is prioritized amid COVID-19, IBS Intelligence - Apr 2020
 Insurance	<i>China Life, Ping An Insurance, China Pacific Insurance, AXA, Allianz, Prudential</i>	<ul style="list-style-type: none"> • Risk: COVID-19 to put a dent in Chinese insurers’ earnings – Insurance Business - Feb 2020 • Reg: China Issues Rules for Insurance Companies’ Asset Management Products, Caixin - Mar 2020 • Opportunity: Chinese insurance industry set for strong growth between 2019-23 despite COVID-19, GlobalData - Apr 2020
 Energy	<i>China National Petroleum Corp (CNPC), Sinopec, China National Offshore Oil Corporation (CNOOC), Dongming Petrochemical Group, Exxon Mobil, Chevron Corp., Royal Dutch Shell</i>	<ul style="list-style-type: none"> • Risk & Reg: Xi Ordered China’s Oil Industry to Drill, Then the Crash Came, Bloomberg - Mar 2020 • Opportunity: Oil price crash to reverberate through LNG markets, S&P Global - Mar 2020 • Opportunity: China’s teapot oil refineries could become ‘money-printing machines’ amid crude price crash, SCMP - Mar 2020
 Technology	<i>Tencent, Baidu, Alibaba, Apple, Samsung, Alphabet</i>	<ul style="list-style-type: none"> • Opportunity: China’s Big Tech companies are using their roles in fighting world’s largest health crisis to turbocharge HealthTech, SCMP - Mar 2020 • Risk: IDC: COVID-19 will drag down China’s ICT market by 10% in the first quarter of 2020, Fierce Telecom - Feb 2020 • Opportunity: COVID-19 How Artificial Intelligence, Data Science And Technology Is Used To Fight The Pandemic, Forbes - Mar 2020
 Automotive	<i>Dongfeng, Changan, SAIC, GM, Volkswagen Group, Toyota, Tesla</i>	<ul style="list-style-type: none"> • Risk: COVID-19 - China manufacturing hub Dongguan faces grim test as global export orders vanish, SCMP - Apr 2020 • Opportunity: COVID-19 - China manufacturing economy bounces back strongly after lockdown, SCMP - Mar 2020 • Risk: Chinese factories face new threat: US anti-virus controls, AP - Mar 2020
 PLS & Healthcare	<i>Shanghai Pharmaceuticals, Sinopharm Group, Jiangsu Hengrui Medicine, Pfizer, Roche, Novartis</i>	<ul style="list-style-type: none"> • Risk: China’s COVID-19-induced supply chain woes fan concerns of possible drug shortages, Reuters - Mar 2020 • Opportunity: Investment Opportunities in China’s Healthcare Sector After COVID-19, China Briefing - Mar 2020 • Opportunity: China’s healthcare spending tipped to grow 12.6% to \$926.8b in 2020, Healthcare Asia - Mar 2020
 Retail	<i>Suning, Gome, China Resource Vanguard, Walmart, Costco, LVMH, Starbucks, McDonalds</i>	<ul style="list-style-type: none"> • Opportunity: Online shopping in China surges amidst COVID-19 outbreak; increase in first-time shoppers in lower-tier cities, GFK - Mar 2020 • Risk: Half of Chinese Retailers Risk Collapse Within Six Months, Bloomberg Quint - Mar 2020 • Risk: COVID-19 wreaks havoc on retail supply chains globally, even as China’s factories come back online, CNBC - Mar 2020



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Macroeconomic Outlook

China's economic outlook remains uncertain despite early signs of recovery

- The Chinese economy was hit hard in January-February 2020, with drastic declines in fixed asset investment (-24.5%), industrial production (-13.5%), and services production (-13.0%). Its exports in the same period plunged 17.2% YoY, while imports fell 4.0% YoY.^{1,2}
- China's official urban unemployment rate for January-February 2020 reached a record 6.2%, with an estimated 5 million jobs lost in the period. Analysts expect the unemployment rate to go higher than 10%, as economic activity in the next quarter will likely be subdued due to lingering disruptions to the manufacturing supply chain, slow recovery in the services sector, and a steep fall in demand from the rest of the world.^{3,4}
- The government quickly swung into action with policy initiatives to prop up the economy, including:
 - Tax cuts for small businesses and new infrastructure projects to boost growth.
 - China's central bank, People's Bank of China (PBoC), injected CNY1.2 trillion (\$174 billion) into the financial system and lowered benchmark lending rates to make more money available for lending to businesses.
 - The government further announced more than CNY3 trillion (\$423 billion) in additional financial support for small businesses.^{5,6}
- Business sentiment seems to have improved owing to the various policy initiatives, as manufacturing activity has shown a rebound. China's official manufacturing purchasing managers' index (PMI) rose from 35.7 in February to 52.0 in March. Government data showed that 96.6% of large firms had reopened as of the last week of March, compared to 71.7% of smaller companies. However, new orders, including export orders, have declined as the contagion has spread rapidly across the world.^{7,8}
- The economy is still poised for a recession in Q1 2020, with GDP expected to decline YoY. Various estimates predict the scale of Q1 2020 GDP decline to be between -3% and -15%. For the full year 2020, the World Bank expects 2.3% GDP growth (baseline scenario) for China, compared with 6.1% in 2019.^{9,10}

Way Forward

Chinese policy makers may look at more policy measures to boost demand as supply-side disruptions are gradually easing. Chinese customs administration and the National Bureau of Statistics (NBS) will release March trade and other economic data, including first-quarter GDP numbers, in mid-April. This data will help explain the real impact of the pandemic on the Chinese economy and may guide policy decisions by the government. However, China's economic recovery may be prolonged due to uncertainties posed by a variety of factors, including a second wave of infections, an expected global recession, worsening deflation due to falling oil prices, and a potential slide in the property market.

¹ COVID-19 crash: How China's economy may offer a glimpse of the future, [World Economic Forum](#), March 31, 2020

² China Jan-Feb dollar-denominated exports tumble 17.2%, imports down 4%, [Reuters](#), March 6, 2020

³ China factory activity unexpectedly expands, but economy cannot shake off virus shock, [Reuters](#), March 31, 2020

⁴ China's economy has yet to reach bottom, [FT.com](#), April 2, 2020

⁵ China's Economic Recovery and Equity Markets, [Goldman Sachs](#), March 31, 2020

⁶ China's economy may not grow at all in 2020. That hasn't happened in 44 years, [CNN Business](#), April 1, 2020

⁷ Coronavirus: China's small factories stabilised in March after lockdown, private PMI shows, [South China Morning Post](#), April 1, 2020

⁸ China's PMI, [National Bureau of Statistics of China](#), accessed on April 4, 2020

⁹ China 2020 GDP to slow to 3.3%, lowest since 1976: survey, [Nikkei Asian Review](#), March 31, 2020

¹⁰ Pandemic to hit growth in Asia, China: World Bank, [Reuters](#), March 31, 2020



Deals Activity

Recent deal activity signals an early recovery in China

Deal activity in China came to a standstill with the onset of the COVID-19 outbreak in late 2019. The disruption in operations led to a 35.8% YoY decline in M&A deal value, to \$51.3 billion, in Mainland China and Hong Kong, while deal volume was down 32.5% YoY to 268 transactions in Q1 2020.¹¹ In 2019, China was engaged in a trade war with the US, and subsequently, M&A activity in the country declined 27.7% YoY to \$294.5 billion.¹²

- **M&A transactions:** In light of the outbreak, bankers have been faced with travel restrictions and are thus unable to carry out face-to-face negotiations, which has given leverage to parties with a upper hand in a deal to take advantage of the situation. Five of the 10 global terminated deals in March 2020 involved Chinese targets.¹³ However, high-stakes M&A deals are still on the table because of their long-term value. For outbound investments, the Chinese are finding European deals more lucrative due to lower valuations.¹⁴ There is uncertainty when it comes to inbound investments, however, since the banking, travel, and airlines sectors have been badly hit, and companies are facing a severe cash crunch. These companies are continuously looking for equity injection, and in the SME layer, the additional pressure may increase the already growing consolidation.
- **IPO transactions:** Transactions worth \$11 billion in valuations were recorded in the IPO market in Q1 2020.¹⁵ The transactions received a boost when the stock market re-opened in February post the Lunar New Year. However, promotional activities remain muted during the lockdown, which has had an impact on IPO transactions overall.
- **VC transactions:** Private Equity/Venture Capitalist (PE/VC) transactions saw an uptick in the last week of March from the advanced manufacturing and edtech sector. During the first six weeks of 2020, deal volume and capital raised in China fell more than 60%, compared with the same period last year.¹⁶ Resultantly, regulatory bodies have relaxed certain norms in the country to encourage deal activity. For example, China Securities Regulatory Commission (CSRC) relaxed share-sale restrictions for VC funds with more than five years of investments after the expiry of lock-up periods.¹⁷

Way Forward

In the short term, companies may shift their strategic focus toward rescue deals, internal restructuring, and other stability-focused mergers. Meanwhile, China's new foreign investment law, which was introduced on January 1, 2020, is expected to help boost foreign investments by creating a level playing field for foreign investors. Although corporates have pushed their investment, expansion, and other restructuring decisions for later, there are high expectations that the deal scenario will recover relatively fast in China and see normal growth in the next 3-6 months. Emerging markets continue to be the focus of Chinese investments, whereas Industrial, Consumer Goods, Technology, and Financial Services continue to be the targeted sectors.

¹¹ Global and regional M&A report Q2 2020, [Mergermarket](#), April 02, 2020

¹² Mergermarket releases 4Q19 M&A report, [Mergermarket](#), January 02, 2020

¹³ ANALYSIS: Where Are All the M&A Deal Terminations?, [Bloomberg](#), March 17, 2020

¹⁴ China's Corporates Are Gearing Up in Europe for M&A Bargains, [Bloomberg](#), April 07, 2020

¹⁵ China defies coronavirus to top global listings in first quarter, [FT.com](#), April 01, 2020

¹⁶ China's VC industry bounces back after coronavirus-induced winter, [Pitch book](#), April 02, 2020

¹⁷ China eases venture capital divestment rules to aid virus-hit economy, [Reuters](#), March 06, 2020